No. 2827

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of

CREECH BROTHERS LUMBER COMPANY, a Corporation, Bankrupt.

A. R. TITLOW, as Receiver of the United States National Bank of Centralia, appearing in the name and stead of Robert G. Chambers, as Trustee in Bankruptcy of the Estate of Creech Brothers Lumber Company, a Corporation, Bankrupt,
Petitioner and Appellant,

vs.

H. W. MacPHAIL,
Respondent and Appellee.

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION.

APPELLANT'S PETITION FOR REHEARING.

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APPELLANT'S PETITION FOR REHEARING.

In view of the importance of this case, not only to the appellant as the receiver of an insolvent bank, but to numerous other creditors whom he represents upon this appeal, and who are rightfully looking to

him to protect their interests, the appellant respectfully requests your Honors to grant a rehearing of this cause and a reconsideration of the issues herein involved.

Your petitioner does not desire to discuss minor issues in the case concerning which there may be room for a divergence of opinion. But he does feel it incumbent upon him to refer to some matters apparently deemed by the court to be of controlling importance as to which your petitioner believes the Court has not been correctly informed.

"CREDITORS ASSENTED."

Your Honors say:

> "There was never any protest upon the part of any of the creditors against the assignment, nor was there any objection to the operation of the plant by MacPhail under its terms."

As to this, permit us to observe that it does not appear that any of the creditors ever knew about the assignment *which was actually made.* The creditors who signed the instruments appearing as Exhibits B-1, B-2, B-3 and B-4, agreed only *to extend the time of payment of their claims* and *to desist from further pressing them in the courts or otherwise*, so long as the plant was operated at a monthly net profit of $1,000.00 or more. This matter is fully discussed at pages 25 to 28 of our opening brief, and we think the

conclusion unescapable that there is no evidence of any creditor's assent to MacPhail's having any lien whatever. The creditors who signed these agreements (and there were many who did not), certainly had a right to insist that the assignment which was actually made should attempt to confer no rights upon MacPhail additional to those which they had agreed to. We respectfully submit that the statement in your Honors' opinion that

> "This assignment followed strictly the terms of the prior agreement signed by all the creditors that could then be ascertained,"

cannot be sustained by a comparison of the creditors' agreements and the assignment that was purported to be made in pursuance of them. The assignment runs far ahead of the previous agreement with creditors, in attempting to give (and this court has held that it does give) a right to priority of payment *out of the assets generally* of the bankrupt company, and not merely out of profits.

Your Honors further say: "No other creditor objects to this claim." The record shows that Hayes & Hayes, bankers of Aberdeen, creditors of the bankrupt, joined in opposing the claim before the Referee (Tr. 40); and in fact, so far as we are able to ascertain, substantially all the creditors of the estate object to the allowance of the claim and have relied upon

this proceeding in the name of the trustee to secure to them what they believe to be their rights.

Further, there were some nineteen creditors (they are enumerated on page 7 of our opening brief) who did not assent at all to this agreement with MacPhail, and who, so far as this record shows, never had any notice or means of knowledge whatever that there had ever even been any attempted assignment, much less as to the terms of it. As to MacPhail's "possession," it was not, we respectfully submit, the sort of possession which would place "the creditors of the estate on inquiry as to the terms of such possession." By the terms of MacPhail's agreement with the bankrupt, he was merely the *agent of the bankrupt* to take charge of its property (Tr. p. 23), and therefore the bankrupt continued in possession after the assignment the same as before. MacPhail was a banker in Raymond, and there is no contention that he was personally in charge of the property. In fact, the property continued under the immediate direction and control of one Lewis, who had been manager of Creech Brothers Company for sixty days prior to the assignment to MacPhail, and thereafter continued in the same capacity (Tr. p. 36). There was nothing at any time to lead anyone to suppose that MacPhail claimed to be in possession, or to have any special rights in regard to the company's property.

That the facts here shown amounted to no more than an attempt on the part of the mortgagee to take and retain possession through an agent of the mortgagor (and we do not think they go even that far). and did not constitute such an open and notorious change of possession as to dispense with the requirements as to recording, is clear upon the authorities.

Ankele vs. Elder, 75 Pac. 29 (Colorado Appeals).
Iowa State Bank vs. Taylor, 67 N. W. 677 (Iowa).
Moors vs. Redding, 45 N. E. 760 (Mass).
Seavey vs. Walker, 9 N. E. 347 (Indiana).
Hereford vs. Benton, 80 Pac. 499 (Colorado Appeals).

DIVIDENDS.

As to dividends having been paid upon the claims of the company while MacPhail was in possession, it is sufficient to observe:

1. That there was nothing in this to put creditors upon inquiry as to MacPhail's connection with the transaction, as these dividends came from the Lumber Company in the ordinary course.

2. MacPhail's administration of the estate was, as both he and his witness Lewis admit (Tr. pp. 46, 40) not beneficial but detrimental to the estate. It does not appear but that the Lumber Company would have paid a part of these claims, even though MacPhail had not taken charge, and surely he could claim no

credit if, in order to pay dividends of 10%, he had through misfortune or mismanagement squandered assets sufficient to pay 50%. In such a case the court could not say that the benefits were such that creditors would be estopped. And yet that is precisely the situation here, although the precise *amount* of the losses which the company suffered under the MacPhail regime do not appear.

3. There is no proof whatever that the bank of which your petitioner is receiver ever received any dividends upon its claim, or that it was a creditor at the time the 10% dividend was paid.

4. The receipt of a *part* of what one is entitled to receive *in its entirety* is not it would seem, such a benefit as to estop any creditor from assailing the legality of the assignment.

ESTOPPEL OF THE UNITED STATES NATIONAL BANK.

Your Honors' opinion seems to rest fundamentally upon the assumption that no creditor is in a position to complain of the MacPhail transaction. We have attempted, both in our opening and reply briefs and in this brief, to meet that contention, both with respect to the creditors generally and with respect to the petitioning creditor. As to the latter, your Honors say:

> "The United States National Bank of Centralia was not then a creditor of the Lumber Company, and of course did not sign the agreement; nor did Titlow its receiver, who now prosecutes this appeal in the name of the trustee in bankruptcy; nor was the bank or its receiver in any way interested in the affairs of the Lumber Company at that time. But the Willapa Harbor State Bank was a creditor, and it signed the agreement authorizing the Lumber Company to execute a contract making an assignment to MacPhail, *and thereafter the Willapa Harbor State Bank, holding the notes of the Lumber Company, sold and assigned the notes to the United States National Bank of Centralia. It was in this manner that the latter bank has become a creditor of the Lumber Company.*"

We have italicized the portion of the quotation just given which your Honors apparently relied upon as creating an estoppel against the appellant. We are not surprised, in view of the frequent reiteration of this statement in our opponent's brief, that your Honors assumed it to be a fact, though the statement was challenged in our reply brief (p. 4). It is, however, not a fact, and there is not one syllable of testimony which even suggests that such is the case. So far as this record shows (Tr. pp. 47, 60), the indebtedness of the bankrupt to the United States National Bank represents money loaned in the ordinary course of business. This indebtedness was represented by seven promissory notes (Tr. 48), all of which were dated after the time of the agreement to MacPhail, and therefore none of them could possibly have been

owned by the Willapa Harbor State Bank at the time of that assignment. All the probabilities under this record lead to the conclusion that this indebtedness to the United States National Bank was a part of the *new indebtedness* which MacPhail testifies (p. 45) was created against the Lumber Company while he was managing it.

Your Honors assign, as a further reason for holding that the United States National Bank is estopped to object to MacPhail's preferred claim, the following:

> "It appears further that at the time the United States National Bank purchased these notes from the Willapa Harbor State Bank * * * it took with actual notice of all the facts concerning the agreement with the creditors and the assignment of the property by the Lumber Company to MacPhail with all the priorities in his favor therein provided for. This notice has been established by evidence that C. S. Gilchrist *was president of the Willapa Harbor State Bank* and was *vice-president and manager of the United States National Bank,* and the testimony shows that Gilchrist was instrumental in obtaining the signature of some of the creditors to the agreement providing for the assignment by the Lumber Company to MacPhail, and the court has so found as a fact."

We respectfully submit that this reason tends to show *lack of notice* rather than *notice.* It is not even contended that Gilchrist was, in respect to obtaining these signatures, *acting for the United States Nation-*

al Bank. His acts, as pointed out in our reply brief, were consistent with one of two things:

(a) That he was acting in a purely private capacity; or,

(b) That he was acting as a representative of the Willapa Harbor State Bank, of which he was president. The latter is sustained by the probabilities, as the Willapa Bank was admittedly a heavy creditor at that time. We submit with great deference that the court, in holding that the knowledge acquired by Gilchrist under these circumstances, constituted notice to another corporation by which he happened to be employed, but which had nothing to do with this particular matter, does violence to the principle irrefutably established that notice to a corporate officer *as an individual* or *as a representative of some other principal,* is not notice to his corporate principal. In addition to the authorities upon this point cited at pages 5 and 6 of our reply brief, we beg to call attention to the following:

Merchants' National Bank vs. Lovitt, 21 S. W. 825 (Mo.).
Bruce vs. Citizens Natl. Bank, 64 So. 82, Ala.
Hanford vs. Duchastell, 93 Atl. 586, N. J.
First Natl. Bk. vs. Fidelity Trust Co., 97 Atl. 75, Pa.
Thomson vs. Central Pas. Ry. Co., 78 Atl. 152, N. J.
Cooper vs. Ford, 69 S. W. 487, Tex.

Kauffmann vs. Robey, 60 Tex. 308; 48 Am. Rep. 264.
De Kay vs. Hackensack Water Co., 38 N. J. Eq. 158.
Amarillo Natl. Bank vs. Harrell, 159 S. W. 858.
Denton Natl. Bank vs. Kenney, 81 Atl. 227, Md.
Flanagan vs. Shaw, 77 N. Y. S. 1070, affirmed 66 N. E. 1108.

In *Merchants' National Bank vs. Lovitt,* 21 S. W. 825 *supra,* which is typical of the cases cited above upon this point, a bank brought an action on a promissory note. The defense of failure of consideration was set up by the maker, who showed that that fact was known to the vice-president of the bank, the note having been given in the course of a transaction between the defendant and the vice-president acting as an individual. In holding that this did not constitute notice to the bank the Court says:

> "It is a general rule that notice of fact acquired by an agent *while transacting the business of his principal,* is notice to the principal; and this rule applies to banking and other corporations as well as to individuals. It is the duty of the agent to communicate to the principal information thus acquired, which would affect the rights of the principal; and the presumption is that the agent has performed his duty in this behalf. If he has not, still the principal should be charged with notice of the existence of such facts thus coming to the knowledge of the agent, because he selects his own agent, and confides to him the particular business. Story, Ag. p. 140. But the reason of the rule ceases *when the agent acts for himself,* and not his principal, and the rule itself ought not to apply in such a case. Accordingly it has

> been held by this Court that knowledge of an unrecorded deed, *acquired by officers of a corporation while acting for themselves and not for the corporation*, will not be imputed to the corporation."

Further, the scope of Gilchrist's duties as an officer of the United States National Bank does not appear, and there is no showing that he had the slightest connection with the subsequent purchase of the Lumber Company's paper by his bank. We submit that your Honors' decision stands without precedent in holding that under facts such as here shown, any notice whatever would be imputed to a corporate principal standing in the position of the United States National Bank.

Your Honors say:

> "That the United States National Bank, as the owner of the notes issued by Creech Brothers Lumber Company to the Willapa Harbor State Bank, is *by reason of the act of the president of the latter bank,* now estopped to deny this claim."

Is this court to sanction the doctrine that one corporation is, by the act of the president of another independent corporation, not connected with it in any way, to be estopped to disclaim responsibility for the acts of that person in his private capacity or as agent of another principal because he happens to be an officer also of the former? Every corporation and individual must of course assume responsibility for the

acts of its own agents. But is the limitation which confines that responsibility to the *scope of the agency* to be swept away? The interests of the two banks here may have been entirely diverse, antagonistic. There would always be the *possibility* of a conflict of interest, disqualifying the same person from acting for both. Is the court not announcing a most novel and most dangerous doctrine in holding that the Centralia Bank is nevertheless responsible for the acts of Gilchrist merely because he happened to be in some other capacity its agent?

The doctrine announced by the court extends the principle of *respondent superior* to *all acts* of agents, no matter whether they are acting in the particular instance in the scope of their employment or in the course of their principal's business.

We have urged this particular matter somewhat at length, since your Honors assign this supposed estoppel as a "further and a conclusive answer to all the objections urged against the assignment." It is founded upon a view of the law which, with great deference, we believe to be fundamentally erroneous, and we feel that our duty to the creditors of the estate whose interests here center in the appellant requires from us a reasonable endeavor to controvert it.

"THE ASSIGNMENT LEGAL."

We raise no objection to the validity of assignments for creditors generally, and we believe that the authorities cited in your Honors' opinion go no further. It is our contention, however, that by virtue of the very exceptional provisions contained in this assignment, it is brought within the condemnation of the authorities cited at pages 16 to 23 of our opening brief, for the reason that it places the property for an indefinite period beyond the reach of creditors, prevents them from reaching the assets of the corporation by the ordinary processes of law, and subjects them to the danger of liens antecedent and superior to their claims. These and other considerations, which are fully pointed out in our opening brief (pp. 15 to 23), and which we need not here again enlarge upon, deprive the assignment in question, we submit, of the character of a valid assignment for creditors and render it, regardless of the intention of the parties to it, a fraudulent conveyance, as being necessarily calculated to hinder and delay creditors.

In the case of *Randolph vs. Scruggs,* 190 U. S. 533, which is typical of the cases cited upon this point, the sole question before the court related to the costs and expenses of administering the trust, and services in preserving it. That is far different from the case at bar, where no claim covering such items has been

presented, but on the other hand a claim for *loans* to the bankrupt. As to these, an assignee for creditors must protect himself by the same means as the law requires of any other person lending money, who desires security. In other words, it is not as an *assignee for creditors* that MacPhail is here asking protection. That he is not such an assignee, we think has been shown, but even if it be conceded that he is, it is not in that capacity, but as a *banker* or a *lender of money* that he is demanding protection. The question of assignment or no assignment is therefore unimportant, since even if the assignment is upheld, it can avail him nothing. And further, in the *Scruggs* case, compensation was allowed to the assignee, even for *services, only in so far as they were beneficial to the estate.* Here there is no question of *services;* and no question of *benefit* since as MacPhail himself admits, his administration of the estate was not beneficial to it.

The real *ratio decidendi* of your Honors' decision seems to be that there is no one in a position to object to this claim. Let us analyze this for a moment.

First, as to the creditors generally. The only assent of creditors is evidenced by the instrument appearing at page 27 of the transcript. That this does not purport to give MacPhail any lien generally, or indeed any lien at all, but amounts to an agreement only by the creditors to extend the time of payment

of their claims, and to desist from pressing them for a certain period, giving MacPhail a right of reimbursement merely out of profits, has we think been abundantly shown both in our opening brief and in this brief.

Second, there is nothing, other than the signature of Exhibits "B" by the creditors, tending to show any notice whatever to creditors.

Third, there were at least nineteen creditors who did not sign these agreements, and who had no notice, or anything to put them on inquiry as to the existence of any such agreement.

Fourth, there are as MacPhail admits (Tr. 45) creditors who became such after the assignment to him.

Fifth, the United States National Bank is not estopped because:

(a) It is a *subsequent* creditor. The notes which it holds are new obligations created by the Lumber Company while under MacPhail's control, and did not pass through the hands of the Willapa Harbor State Bank, as counsel erroneously states and as the court assumes.

(b) The notice to Gilchrist cannot affect the United States National Bank, since he was not acting for it in the transaction; and the same observation

applies to Dysart who is not shown to have had any connection with the United States National Bank whatever so far as this transaction is concerned.

Sixth, the whole question of estoppel as against this creditor is immaterial since this is a proceeding by the Trustee in Bankruptcy representing all the creditors of the estate. This question is fully discussed at pages 1 to 4 of our reply brief.

The simple question presented, as it seems to us, may be stated as follows:

MacPhail claims priority of payment, not for *services* nor upon the theory that he has *enhanced the value of the fund* to be distributed, but upon the basis of a *lien arising out of contract.* Whether he is, as he claims to be, an assignee for creditors, is immaterial, since he here is claiming rights only as a lender. Has he fulfilled the requirements of the law with respect to sustaining such a lien as against the Trustee in Bankruptcy? We think he has not, and that he must fail if there is anyone in a position to complain. We earnestly submit, in behalf of creditors holding approximately $137,000 in claims which will be rendered valueless if your Honors' decision is upheld, that there is no creditor, and least of all the objecting creditor, who is estopped to question the validity of this claim; and that the equities of the case demand its disallowance.

We respectfully request that the court rehear and reconsider the questions involved in this appeal.

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Of Counsel.

The undersigned, one of counsel for the appellant, does hereby certify that in his judgment the foregoing petition for rehearing is well founded, and that it is not interposed for delay.

R. P. OLDHAM,
Of Counsel for Appellant.